sole possession of the information necessary to evaluate its rates.28/

- If the current rate filed with the franchising authority is greater than the relevant benchmark rate, the cable company would be obligated immediately to reduce its rates to the benchmark rate. If the cable company seeks to justify a rate higher than the benchmark rate, the cable company would (1) bear the burden of proof and (2) would be subject to having its rates reduced below the benchmark based upon the evidence produced. The franchising authority or subscribers also could seek at any time by subsequent complaint to reduce the cable company's rates below the benchmark rate to a cost-based level.
- If the current rate filed with the franchising authority is less than the relevant benchmark rate, the rate would remain at its current level. The cable company may seek to increase the rate to the benchmark (or higher) rate level by means of a rate increase application,

28/ NPRM, p. 44.

subject to the same conditions as set forth in the preceding paragraph. The franchising authority likewise may seek a reduction of the cable company's rates below the current rate by means of a complaint, if it believes that the current rates is unreasonably high on a cost-of-service basis even though the rate is below the benchmark.

- After the filing of the current rate, the franchising authority would have 180 days in which to act, after which the lower of the current rate or the applicable benchmark rate would be deemed reasonable. (The Commission should allow more than the 120 days to which it alluded,29/ because it may take a while for some local communities which seek to become franchising authorities to evaluate their first rate for the basic service tier. Alternatively, if a significant number of franchising authorities do not seek certification, the Commission will be

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29/ NPRM, p. 43, and n. 113.

required to review the basic service tier rates of numerous cable companies.)

- If the franchising authority determines that the effective (i.e., the lower of the current or benchmark) rates are too high, the Commission should authorize the franchising authority to order refunds from the later of the date of the filing of the rates, or 180 days from enactment of the Cable Act.

2. Procedures with respect to Rate Increase Applications.

We agree that it is not reasonable to expect that meaningful review of rate increase applications can occur within thirty days of the filing of the proposed change.30/ We also agree that, although the concept of allowing rates to go into effect subject to refund would arguably cure the time crunch for reviewing and approving or rejecting rate increases, refunds are, at best, an imperfect cure for consumers who are overcharged for service. The Coalition believes that a combination of these two concepts may best balance the interests of the consumers in new programming31/ and in protection against excessive rates.

30/ NPRM, p. 43.

31/ NPRM, p. 43.

The Coalition recommends that the Commission establish the following regimen for the review of rate increase applications.

- Rate increase applications may not become effective unless they are preceded by sixty days prior public notice;
- A rate increase which has met the sixty days notice requirement will become effective at the end of the sixty day period unless the franchising authority (1) has rejected the rate increase application, in which case the sixty day notice period will be deemed not to have begun to run, or (2) has suspended the rate increase for a period not to exceed 150 days from the issuance of the order suspending the rate increase; and
- Upon conclusion of the franchise authority-ordered suspension period, if the review of the rate increase is not completed, the rate increase may be allowed to become effective, subject to refund at a rate of interest which is adequately protective of the interests

of consumers (e.g., prime rate plus two percentage points).

The Coalition believes that the foregoing will provide adequate protection to the public while affording both the cable system and the franchising authority with incentive to be cooperative in the regulatory process. The key remains that the cable system must be forthcoming with information necessary to permit a meaningful review of the rate increase application. The prospect of suspension or rejection of a filing should provide incentive to prevent footdragging.

3. Procedures with respect to Complaints Alleging Unreasonable Rates.

The Commission should establish procedures pursuant to which the franchising authority will process complaints, filed by consumers, cable systems, or raised on the franchising authority's own motion, which allege unreasonable rates for the basic service tier. Any rate alleged to be unreasonable should be subject to refund: (1) in the case of a complaint raised on other than a franchising authority's own motion, from a date thirty days after the franchising authority determines that the complaint alleges facts sufficient to warrant its consideration, or (2) in the case of a complaint on the franchising authority's own motion, from the date that the franchising authority issues the complaint.

4. The Commission Should Not Adopt Abbreviated Procedures Which Do Not Protect the Public.

The Commission does not propose to establish formal hearing procedures on proposed rate increases or rate-related disputes.32/ The Coalition urges the Commission not to prejudge the level of formality needed by individual franchise authorities. Congress has reregulated the cable industry not because the industry was restrained in its business activities and cooperative in response to complaints, but rather because the cable industry was marked by examples of crass greed. It is naive to assume that this industry will accept willingly the requests of local franchise authorities. In addition, the highly technical nature of the industry may require that something more than a "canned" written information be provided. Congress intended that the Commission establish a scheme of effective regulation, not a rubber stamp. The Coalition therefore requests that the Commission not prevent a franchise authority from instituting more formal hearing-type procedures with all powers necessary and appropriate to discharge its obligations, including the right to subpoena witnesses and records, if the franchising authority deems it necessary.

32/ NPRM, p. 44.

5. **<u>The Commission Should Not Permit Rates for Basic Tier Service to be Increased Without Regulatory Review.</u>**

The Commission seeks comment on whether "certain price changes caused by factors outside the operator's control" should not be deemed a rate increase but rather should automatically be passed through without prior regulatory review.33/ This proposal is markedly biased in favor of the cable operator and contrary to the Commission's obligation to ensure that the rates for the basic service tier are reasonable.

The Commission's proposal appears based on the assumption that certain cost increases may be readily known or ascertained and, as such, little purpose would be served by requiring the cable operator to obtain regulatory approval before being allowed to include such costs in rates. If this is indeed the Commission's assumption, it is wrong. The fact that one isolated cost of doing business may have increased does not mean that other costs of doing business may not, at the same time, have decreased. For example, although taxes may increase over a given period of time, depreciation of rate base investment may warrant an overall reduction in rates, not an increase. The Commission's proposal would allow automatic recovery of cost

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33/ NPRM, p. 44.

increases, but would also allow cable operators to retain the excess profits resulting from cost reductions (in the absence of a complaint). The Coalition submits that this would be an abdication of the Commission's responsibility under Section 623(b) to ensure the reasonableness of basic service tier rates.

6. The Cable Act Gives Local Franchising Authorities The Authority To Set Rates.

The Commission questions whether local franchising authorities have the authority under the Cable Act to set rates for the basic service tier.34/ The Coalition believes that such power is implicit in the statutory scheme which the Congress has established.

Section 623(b)(5)(A) obligates the Commission to establish standards and procedures by which local franchising authorities may implement and enforce the regulations which the Commission is obligated to promulgate. The Commission must establish regulations which ensure that the rates charged for the basic service tier are reasonable;35/ therefore, no franchising authority may permit an unreasonable rate to be charged. In other words, the franchising authority must reject an unreasonable rate.

34/ NPRM, pp. 44-45.

35/ Cable Act, Section 623(b)(1).

Typically, the regulatory authority to accept or to reject connotes the authority to condition.

The right to set a rate is also consistent with Congress' desire to minimize the administrative burdens which the Cable Act imposes on operators and franchising authorities. If the franchising authority determines that one component of a rate is excessive, must it reject the rate increase application in its entirety, or may it modify the rate to be allowed in order to set more accurately (and cost-effectively) the reasonable rate for the basic service tier? Constraining the franchising authority simply to approving or rejecting a rate increase application forces the franchising authority to reject a rate if it finds only one component of a rate unreasonable. This is substantially more costly and inefficient than allowing the franchising authority to modify the rates which it has just reviewed.

Allowing franchising authorities to set rates does not unduly prejudice cable operators. To the extent that a cable operator objects to the rates set by a franchising authority, the cable operator may appeal that decision or file a new and superseding rate at its convenience.

III. BENCHMARK RATES VS. COST OF SERVICE REGULATION.

A. Overview

The Coalition has a strong interest in the FCC adopting regulations that provide for the effective rate regulation of cable operators, while at the same time keeping the act of regulating itself as simple as possible. The FCC seems to understand these twin goals36/, but the Coalition believes (as set forth in more detail below) that the proposals of the FCC elevate simple regulation over effective regulation. The Coalition submits that an overriding purpose of the Cable Act is to ensure that subscribers pay reasonable rates37/ -- and that if that goal is not achieved, then the FCC has not fulfilled the clear mandate of the 1992 Act. With this basic premise in mind, the Coalition makes the following comments regarding regulation concerning the formulation of basic tier rates.

The FCC states its intention to adopt a framework that permits cable operators to charge a benchmark rate, with the right to seek to prove, on the basis of actual costs, that they are entitled to higher rates.38/ Coalition believes that such a scheme will result in subscribers in most communities paying excessive rates, contrary to the will of

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36/ NPRM, p. 19.

37/ See, e.g., Cable Act, Section 623(b)(1).

38/ NPRM, p. 22.

Congress. The first point to be made is that the reason that the Cable Act was passed was that Congress understood that, due to the absence of competition in the vast majority of communities served by cable, rates are excessive.39/ Thus the objective of regulation must be (i) to get those excessive rates to reasonable levels and then (ii) to maintain them at reasonable levels.

In terms of the first goal, i.e., getting existing rates to reasonable levels, the benchmark proposal of the FCC (without more) will not succeed. No matter how carefully crafted, benchmarks are based on averages, and averages do not necessarily reflect the actual costs of any cable operator. People 6 feet tall drown in the Rio Grande, which has an average depth of 6 inches; the average American male is 5 foot, 9.7 inches tall, but relatively few American males are that height. Inevitably, benchmark rates will be well above the reasonable rate (defined here as cost plus a fair return, which should be the result where workable competition is at play) of many cable operators, whether or not the past actual rates of such operators are above or below the benchmark. Thus for such operators, the benchmark approach will merely give Commission blessing to excessive rates.

39/ House Report, pp. 30-34.

By the same token, the benchmark rates will be below the reasonable rate of some cable operators, but the FCC proposes that those cable operators that believe that they can cost-justify a rate higher than the benchmark be permitted to make such a showing. Thus what the FCC is proposing is a "heads the cable operator wins, tails the subscriber loses" scheme of ratemaking. Cable operators with low costs vis-a-vis the benchmark will charge the benchmark, and thereby continue to reap excess profits at the subscribers' expense, and cable operators with high costs will press to charge rates higher than the benchmark rates under the FCC's proposal. The Coalition does not believe that this approach is either in the public interest or consistent with the letter or spirit of the 1992 Act.

Because benchmarking as proposed by the FCC is guaranteed not to produce the statutorily required result of reasonable rates for most subscribers, the question then becomes, what approach will achieve that result. The obvious answer is traditional cost-of-service regulation on an operator-by-operator basis. This approach would permit scrutiny of the actual costs of a given operator, and permit recovery of those costs prudently incurred, plus a fair rate of return. The problem with this approach, as the FCC correctly identifies,40/ is that it is more difficult to

40/ NPRM, p. 26.

administer than an approach like benchmarking, and many communities may not want to have to engage in this exercise due to their own lack of resources, though under the FCC approach they would have to engage in this exercise to some extent if the cable operator sought to have rates above the benchmark approved.

The Coalition submits that neither the benchmarking approach as proposed by the FCC nor straight cost-of-service regulation is the answer to ensuring reasonable rates for subscribers while at the same time keeping the administration of the system as simple as possible. The Coalition believes that a benchmarking approach should be adopted, but only if there are appropriate safeguards. The advantage of the benchmarking approach is that it is relatively simple to administer, but, as noted above, it will not by itself result in reasonable rates. There must therefore be a cost-of-service governor on the system.

The Coalition suggests that the most sensible approach, given the twin goals of reasonableness and simplicity, is to establish benchmark rates (as discussed in more detail below) and to permit <u>both</u> the cable operator <u>and</u> the franchising authority to deviate from the benchmark on the basis of cost-of-service regulation. Thus, for example, if both the franchising authority and the cable operator were satisfied that the benchmark rate was appropriate (from their very different perspectives), then it would remain in place; but if either the cable operator or the franchising authority felt that the benchmark did not result in reasonable rates, it could initiate a cost-of-service review (which is also discussed in more detail below).

This approach would provide balance to the regulatory system, which balance is missing from the NPRM approach as, under it, the FCC would only extend the right of cost-of-service review to the cable operator. Thus under the FCC's proposed approach, rates could only go up from the benchmark, which assumes incorrectly that the benchmark rate is the reasonable rate for those operators not seeking cost-of-service review, whereas the Coalition submits that that is not the case -- that for those cable operators not seeking review, many will be charging excessive rather than reasonable rates. Thus the benchmarking approach, in order to achieve the goal of ensuring reasonable rates, must have a mechanism permitting the franchising authority to reduce rates below the benchmark where costs justify that result.

B. Discussion

1. In General

In this pages 20-35 of the NPRM, the FCC raises a host of issues on which it seeks comments in regard to the overall question of how best to regulate rates for basic service tier rates. Unfortunately, time and the limited data available to the members of the Coalition regarding the cable industry make it difficult to answer with any degree of certainty many of the questions asked by the FCC.

Not only does the absence of meaningful data handicap the FCC and interested parties, like the members of the Coalition, but in addition such void will allow the cable operators to make claims regarding both the level of their rates and the adverse impact of regulation on them which cannot be verified. The Coalition urges the FCC to begin the collection on a systematic basis of the data necessary to regulate, on an ongoing basis, the cable industry.41/ While such data collection efforts will surely be met with resistance from the operators, since such data collection is the sine qua non of effective regulation, it is for that very reason that such data must be collected. Ultimately, regulation is no better than the data in the hands of the regulator.

In its discussion of the statute, the NPRM solicits comments on "the extent to which we should design our regulations to produce rates for the basic service tier that

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41/ The type of data that the Coalition has reference to, as discussed in more detail below, is the data that would be elicited in Appendix A to the NPRM (p. 83-85), as opposed to the data elicited by the FCC's Order released in this docket on December 23, 1992, relating to Cable rates.

are generally lower than those in effect in the cable industry for the lowest service tier at the time of enactment of the Cable Act of 1992."42/ The answer to this question is important because many of the FCC's later recommendations seem to be grounded on the notion that existing rates may be reasonable.

The Coalition submits that it is because existing rates are excessive -- because existing rates are extracting monopoly rents -- that Congress was impelled to pass the Cable Act.43/ The impetus for passage of the 1992 Act was the fact of runaway rates to subscribers. Thus it would be counterproductive to make any assumptions regarding existing rates, except that those rates being charged by cable operators in non-competitive service areas are excessive. It is the mandate of the Cable Act to restore cable rates to reasonable levels, not simply to curb further abuses. Thus any system of regulation that does not correct the rampant overcharges to which subscribers across the nation are subjected will fall painfully shy of the statutory requirement to ensure reasonable rates.

In this regard, the Coalition is concerned that the FCC in its NPRM discussion of basic service tier rates has

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42/ NPRM, p. 21, n. 61.

43/ See, e.g., Cable Act, Section 2(a); House Report, pp. 30-34.

failed to focus sufficiently on the precise content of the "Commission obligation to subscribers" (emphasis supplied) set forth in Section 623(b)(1). As acknowledged by the Commission44/, under Section 623(b)(1), the Commission must by regulation not only ensure that basic service tier rates are "reasonable," but must specifically design its regulations:

> to achieve the goal of protecting subscribers of any cable system that is not subject to effective competition from rates for the basic service tier that exceed the rates that would be charged for the basic service tier if such cable system were subject to effective competition. [emphasis supplied.]

Given the clarity with which this single paramount "goal" regarding basic service tier rate regulation is set forth in Section 623(b)(1), the Coalition is troubled by the way in which the Commission nonetheless immediately proceeds to refer generally to regulations:

> designed to achieve the goals set forth in the statute and reflective of [Section 623(b)(2)(C)] enumerated factors.45/

The above Commission reference to multiple statutory goals linked with the seven Section 623(b)(2)(C) "factors" suggests that the Commission has failed to recognize that

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44/ NPRM, p. 19.

45/ NPRM, p. 20 (emphasis supplied).

Sections 623(b)(1) and (2) establish a clear hierarchy -- one in which the single goal of protection against basic service tier rates exceeding competitive levels is to be achieved by regulations which, inter alia, "take into account" the seven factors listed in Section 26(b)(2)(C) -- i.e., a regime in which the seven "factors" are clearly subsidiary to the single Section 623(b)(1) goal. The Coalition submits that this failure of distinction by the Commission is what then leads the Commission to inquire:

> whether Congress intended that we should give primary weight to the goal of protecting subscribers of any cable system from rates higher than those which would be charged if the system were subject to effective competition.46/

and to then:

> observe that the statute lists rates for cable systems subject to effective competition as only one of seven factors to be taken into account in establishing regulations regarding the basic tier.47/

The basic errors seen in the above two passages are clear. As to the first passage, Coalition submits that Section 623(b)(1) is strikingly precise in requiring that the Commission must in fact give primary weight to the goal of protection from supra-competitive basic service tier

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46/ NPRM, p. 21, n. 61 (emphasis supplied).

47/ Id. (emphasis supplied).

rates. The Coalition suggests that the only way the Commission can have any doubt on this score is to have failed to note: (1) the subsidiary nature of the seven "factors," and (2) the precise content of the first of those factors. With regard to latter point, the Coalition notes that Section 623(b)(2)(C) lists that first factor as:

> (i) the rates for cable systems <u>if any</u>, that are subject to effective competition; [emphasis supplied.]

The quoted language clearly refers to Commission examination of cable systems <u>other than</u> the non-competitive ones which the Commission is required to protect by regulation under Section 623(b)(1). The underscored "if any" merely serves to emphasize that in fact no such competitive systems may exist, and that thus, by definition, examination of "competitive" systems cannot be the sole means by which the Commission through regulation seeks to establish the equivalent of competitive rates on non-competitive systems. This recognition of the potential complexities of establishing competitive rates on non-competitive systems in no way alters the fact that such competitive rate establishment is the precise, <u>single</u> obligation imposed upon the Commission by Section 623(b)(1). It therefore totally fails to support the Commission's erroneous conclusion that:

> while requiring reasonable rates, the statute does _not_ _per_ _se_ require that aggregate rates for the basic tier of a cable system not subject to effective competition be no higher than the rates charged by systems subject to effective competition.48/

The Coalition submits that the above description, when properly read to assure adjustment for possible cost-based differences between systems, due to such factors as differences in the number of channels contained in a given system's basic service tier, _is_ in fact exactly the _per se_ requirement imposed on the Commission by Section 623(b)(1).

Turning now to the FCC's tentative conclusions regarding the pros and cons of benchmark versus cost-of-service regulation49/, we have addressed them in general above, and will address them in more specific terms below in response to the detailed inquiries in the NPRM.

2. Benchmarking

The NPRM states that: "The benchmark itself would be based on selected general industry characteristics and, if well designed, could assure that the rates of each individual system subject to it are reasonable."50/ The Coalition disagrees. As noted at the outset, a benchmark rate, no matter how well conceived, will consist of averages

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48/ NPRM, p. 21, n. 61 (emphasis supplied).

49/ NPRM, p. 22.

50/ NPRM, p. 24.

and thus will not assure reasonable rates as to any particular individual system. Particularly worrisome is the FCC's concern about "potential tension" between the need to set "an accurate benchmark using sound data collection processes and ratemaking methodologies, and the command of the Cable Act, on the other hand, to simplify regulation" and its conclusion that "[e]ven the simple formula ... would protect consumers from excessive rates and, by eliminating the need for detailed cost-based regulation in many jurisdictions, would keep the costs of administration and compliance low."51/

The only thing worse than no regulation of a non-competitive industry is ineffective regulation. The use of a simple formula to satisfy the command of the Cable Act to ensure reasonable rates will guarantee ineffective regulation. As the discussion above makes clear, the FCC's concern for simplifying regulation must not blind it to its central mission of putting in place procedures to ensure reasonable rates.

Also worrisome is the FCC's suggestion that "[a]llowing higher-cost systems to opt for cost-based regulation if the benchmark rate proved unreasonably low would, however, provide a safety valve to prevent confiscatory rates."52/

51/ NRPM, p. 24.

52/ NPRM, p. 24.

The FCC's primary concern should be that benchmark rates are too high, not too low, and yet that problem never seems to be entertained in the NPRM. While the Coalition does not oppose establishing a method under which operators can justify higher rates, there must also be a methodology in place for franchising authorities to reduce overstated benchmark rates to reasonable levels for given operators.

The NPRM suggests that a benchmark not based on the costs of individual systems "could also provide an incentive for systems to be efficient by allowing low-cost systems to keep any savings achieved through increased efficiencies" and that "[a]llowing higher cost systems to opt for cost-based regulation if the benchmark rate proved unreasonably low would ... provide a safety valve to prevent confiscatory rates."53/ Again, the Coalition agrees that the FCC should be concerned about confiscatory rates, because they are not reasonable, but the suggestion that where benchmark rates are too high (*vis-a-vis* actual costs), the result is an incentive, whereas where the benchmark rates are too low (*vis-a-vis* actual costs), the result is confiscation, seems to reflect an overall pro-operator bias throughout this section of the NPRM. The fact of the matter is that where a benchmark rate is sufficiently above or below actual costs, as it inevitably will be, the rates are unreasonable in *both*

53/ NPRM, p. 24.

instances and must be adjusted. The procedures recommended in the NPRM do not satisfy this requirement.

The NPRM states that: "Under a benchmark alternative, the Commission could separate cable systems into distinct classes based upon specified variables and then define a benchmark for each class of systems."54/ While this approach does not cure the basic infirmity in benchmarking, it is absolutely essential if benchmarking is to have any validity at all. There are a host of different variables that separate systems, some of which the NPRM lists55/, and these variables must be considered in establishing benchmark rates for cable systems of different sizes serving different parts of the country. And to the extent such data is not forthcoming as a result of the Commission's Order herein of December 23, 1992, it will not have such data in the foreseeable future. The Coalition does not have sufficient information at this time to make recommendations regarding the specific criteria to consider in establishing separate classes. The Coalition urges the FCC to collect and use such information so that it can establish classes that will permit the determination of representative benchmark rates.

54/ NPRM, p. 24.

55/ NPRM, pp. 24-25.

The NPRM states that: "One effect of benchmarks could be to cause the rates of the systems subject to the same benchmark to converge over time to that benchmark."56/ Such a suggestion is questionable for several reasons. It seems to assume that once a benchmark is set, cable operators will be permitted to charge that benchmark, whereas the Coalition urges (i) that the benchmark be considered a ceiling (absent a cost showing by the cable operator that it is entitled to a higher rate), (ii) that cable operators not be permitted to increase their existing rates up to the ceiling absent a specific showing of good cause (a subject to be discussed in more detail below in regard to price caps), and (iii) franchising authorities be permitted to initiate proceedings to reduce cable operators' rates below existing levels (whether or not the existing level is below the benchmark). Thus while there may be some convergence of rates toward the benchmark, such convergence, if it occurs, should happen because the benchmark has some vitality as a cost-of-service proxy, not simply because it is the benchmark.

With regard to the question of whether benchmark rates should be "customized" to reflect individual system characteristics57/, several points should be made.

56/ NPRM, p. 25.

57/ NPRM, p. 25.

First, to the extent that a conscientious job is done in setting up different classes for establishing benchmark rates, there will be less need for customizing. Second, to the extent that customizing is permitted, it must be a two-way street, viz: there may be certain cost factors that can so dramatically differ even within the same class, that they must be handled individually, in which case the franchising authority should be permitted to use the actual number for the cable operator in its area without regard to whether the result is to drive the rate up or down vis-a-vis some median number.

The NPRM notes that: "Another important adjustment factor is a general change in the cost of doing business."58/ The key consideration in focusing on the cost of doing business is to understand that it can go down as well as up. Thus even though inflation may be driving up costs generally, technology improvements, increased market penetration, and a host of other factors can drive down the unit cost of providing service. Thus any adjustment factor may not simply look at a price index, like the CPI or PPI, and be applied in rote fashion to increase cable rates. The FCC must keep its benchmark rates updated based on the collection of current and meaningful information, while at the same time permitting both cable operators and

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58/ NPRM, p. 25.